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BEFORE THE ARIZONA CORPORATION COMMISSION2 JAMES M. IRVIN
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2001 JAN -8 P 3 14

ARIZONA CORPORATION COMMISSION
DOCUMENT CONTROL6 IN THE MATTER OF THE APPLICATION)
OF U S WEST COMMUNICATIONS, INC.)
7 A COLORADO CORPORATION, FOR A)
HEARING TO DETERMINE THE EARNINGS)
8 OF THE COMPANY, THE FAIR VALUE OF)
THE COMPANY FOR RATEMAKING)
9 PURPOSES, TO FIX A JUST AND)
REASONABLE RATE OF RETURN)
10 THEREON AND TO APPROVE RATE)
SCHEDULES DESIGNED TO DEVELOP)
11 SUCH RETURN.)

DOCKET NO. T-01051B-99-0105

Arizona Corporation Commission

DOCKETED

JAN 08 2001

12 IN THE MATTER OF U S WEST)
13 COMMUNICATIONS, INC. TARIFF FILING)
FOR APPROVAL OF A \$.25 SURCHARGE)
14 FOR A CALL TO U S WEST 800 SERVICE)
LINE FROM A PAY TELEPHONE)
15

DOCKET NO. T-01051B-00-0369

16 STAFF'S NOTICE OF FILING TIMELINE OF SIGNIFICANT EVENTS
17 AND DETAILED SUMMARY OF SETTLEMENT AGREEMENT18 Pursuant to the Procedural Order dated January 2, 2001, Commission Staff hereby
19 submits our timeline of significant events and detailed summary of the Settlement Agreement
20 between Staff and Qwest Corporation.21 The detailed summary is in two parts. First is a chronological description of events
22 in the context of Qwest's (initially U S West's) request for a change in depreciation rates in docket
23 number T-01051-97-0689. The second part is the overlapping chronological description of events
24 occurring in the rate application in docket number T-01051B-99-0105.25 The detailed summary of the Settlement Agreement is constructed by interlineation
26 into the body of the Settlement Agreement itself. Following each section of the Settlement
27 Agreement, a description and summary of the content and purpose of the section has been inserted.
28 The summary is in bold and italics, so as to distinguish it from the text of the Settlement. Similarly,

1 a summary of Attachment A, the Price Cap Plan, has been prepared. The format is the same, and
2 it is provided immediately following the summary of the Settlement Agreement.

3 RESPECTFULLY SUBMITTED this 8th day of January, 2001
4

5
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12 The Original and fifteen copies of the
13 foregoing were filed this 8th day of January,
14 2001 with:

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SUMMARY OF US WEST'S DEPRECIATION RATE CASE
DOCKET NO. T-01051-97-0689

DATE	SUMMARY OF PROCEEDING
10/10/95; refiled 12/8/97	U S West's Application for Changes in Depreciation Rates with Executive Summary. Application requests order waiving A.A.C. R14-2-102 authorizing application to go forward , since outside of a general rate application. Application includes Executive Summary of Jerry D. Harris and 1995 Depreciation Rate Study
initially filed 11-12-97, refiled 12/8/97	Supplement to Application. Supplement includes November 1997 update of depreciation study with revised depreciation life parameters and associated depreciation rates, three-year amortization of depreciation reserve deficiency and waiver of A.A.C. R14-2-102.
2/23/98	Procedural Order granting intervention of AT&T and RUCO and requests Staff and Intervenors to file responses to U S West's request for waiver.
3/98	Staff, RUCO and AT&T filed responses to U S West's application request for waiver.
4/30/98	Staff requested a procedural order scheduling dates for prefiled testimony and hearing.
5/8/98	HO Proposed Order for Open Meeting denies U S West's request for waiver and exceptions were filed.
5/18/98	Memorandum from Exec. Sec. explaining agreement with U S West.
5/26/98	Decision No. 60928 granting waiver to proceed with depreciation rate case, to issue a procedural order, and orders the Company to file a rate application 60 days after the final decision in this matter.
5/27/98	Procedural Order sets discovery and pleading schedule and notice requirements.
6/15, 25/98	U S West files direct testimony
7/98	Staff, RUCO and Department of Defense file testimony.
8/98	U S West files Rebuttal Testimony, parties file surrebuttal testimony and U S West files rejoinder testimony.
8/28/98	Procedural conference held wherein Staff and the Company requested a continuance of the hearing date in order to discuss settlement proposals.
9/16/98	Procedural Order carries hearing date from 9/21/98 to 10/1/98 and a telephonic procedural conference is schedule for 9/24/98.
10/1/98	Procedural order providing status of settlement negotiations, continuing the hearing to November 4, 1998 and setting a procedural conference for 10/23/98. U S West was also directed to file its rate case application by December 21, 1998
10/14/98	Staff and US West filed a proposed Settlement Agreement.
10/15/98	Procedural Order continues hearing to 11/12/98, re-sets procedural conference to 10/29/98 and calls for all other parties to file comments regarding the proposed settlement agreement.
10/98	Commissioners Jennings and Kunasek file comments; Intervenors filed

	exceptions to proposed settlement agreement and supporting testimony.
11/4/98	Procedural order requires Staff and the Company to identify witnesses and testimony of those witnesses in support of the settlement and response to exceptions.
11/12,13/98	Two-day evidentiary hearing held.
12/10/98	US West filed a motion to postpone filing rate application.
12/11/98	Post-hearing briefs and responses filed by all parties
12/17/98	Procedural Order granted US West's motion and continued the filing of its rate case.
2/3/99	HO's Recommended Opinion and Order for Open Meeting.
2/19/99	Decision No. 61524 disapproves proposed settlement agreement and calls for a procedural order to establish pleading schedule and set dates for testimony and hearing.
2/24/99	Procedural order re-establishes the discovery schedule and procedural orders of 5/27/98 and schedules a hearing on April 27, 1999.
3/99	The parties filed supplemental and rebuttal testimony
3/31/99	Procedural Order re-scheduling prehearing conference from 4/14 to 4/15/99.
4/27/99	Evidentiary Hearing held and post briefing schedule ordered in addition to late-filed exhibits.
5/99	Post-hearing briefs and replies filed by all parties
9/1/99	HO's Proposed Order for Open Meeting and exceptions were filed.
9/8/99	Commissioner's letter to the parties requesting additional information.
9/14/99	Open Meeting and oral argument.
9/17/99	Decision No. 61945 denied request for deficiency reserve amortization directed Staff and the Company to jointly submit proposed depreciation lives using the equal life group method and Staff's projection lives, salvage parameters and survivor curves within 10 days from the date of the order.
9/27/99	Staff and US West jointly requested an extension to 10/1/99 for report to be filed.
10/1/99	Staff and US West filed separate, conflicting reports.
10/18/99	Staff and US West requested continuance of rate case application due to depreciation dispute
10/20/99	Procedural Order sets conference on 10/28 to resolve dispute
10/28/99	Procedural conference held and the parties were ordered to file initial and reply briefs regarding the depreciation dispute, to be followed by the HO's Recommended Opinion and Order for Open Meeting in January 2000.
11/30/99	Staff submits request for clarification or amendment of Decision No. 61945.
12/3/99	Parties filed replies to Staff's request for clarification and Staff filed a reply brief.
12/17/99	HO filed a proposed decision for the January 6, 2000 Open Meeting and parties filed exceptions and comments.
1/6/00	Open Meeting oral argument regarding depreciation calculation dispute. The HO was ordered to issue a procedural order to schedule a conference limiting the scope of argument to seven accounts and sub-accounts; requiring calculations to exclude truncation and be in compliance with FCC accounting

	methods; and required additional pre-filed testimony.
1/7/00	Procedural order in compliance with Open Meeting directives above and HO set procedural conference on January 10, 2000.
1-20, 21-00	US West filed a Motion to Compel AT&T, Cox and e-spire to file response to the February 24, 1999 Procedural Order request for information
2/4/00	DOD files Direct Testimony of Richard Lee.
2/10/00	US West files testimony of Wu and White; RUCO files testimony of Johnson and Staff files testimony of Leas ordered by Commissioners pursuant to the Procedural Conference..
2/22/00	Rebuttal testimony filed by all parties. Staff additionally filed a Motion to Strike Portions of US West's testimony
2/28,29/00	Evidentiary Hearing.
3/15/00	HO's proposed order for Open Meeting
3/21-24/00	Exceptions to Proposed Order filed.
3/28/00	Open Meeting oral argument
4/6/00	US West's Application for Reconsideration
4/11-13/00	Commissioners' comments filed.
4/19-20/00	Additional testimony filed by Staff pursuant to request of Commissioner's Aid.
5/4/00	Decision No. 62507 decides US West's depreciation rate inputs for contested property accounts.
5/24/00	Application for Rehearing filed by RUCO.

SUMMARY OF QWEST RATE CASE
DOCKET NO. T-01051B-99-0105

DATE	SUMMARY OF PROCEEDING
1/8/99	Application filed by US WEST
2/26/99	Application docketed
3/4/99	Procedural order issued, scheduling hearing for 11/4/99 and setting dates for filing testimony
3/18/99	Qwest files supplemental direct testimony regarding revenue requirement
4/5/99	Qwest files revised exchange maps omitted from application's tariff pages
7/19/99	AT&T files motion to compel responses to data requests
8/11/99	Staff files motion to extend hearing and testimony dates
8/17/99	Procedural order postpones testimony dates and reschedules hearing for 1/10/00
9/3/99	Staff files motion to compel responses to data requests
9/3/99	Procedural order rescheduling prehearing conference
9/17/99	Procedural order on discovery disputes
10/18/99	US WEST and Staff file joint motion to continue the procedural dates pending resolution of the depreciation case
10/19/99	Procedural order scheduling filing of testimony following Qwest's filing of depreciation schedules
1/4/00	Procedural order continuing 1/6/00 prehearing conference indefinitely
1/7/00	Procedural order continuing hearing pending resolution of depreciation docket and ordering suspension of timeclock rules
1/21/00	Staff files motion to have US WEST update the test year
2/2/00	WorldCom's motion to sever deregulation/competitive zone issues from rate case
3/16/00	Procedural order setting date for oral argument on motion to sever
3/30/00	Procedural order continuing procedural conference on motions to compel
4/4/00	Procedural conference held to discuss Staff's motion to have test year updated. US WEST is directed to re-file its schedules by 5/20/00 using a calendar year 1999 test year
4/10/00	Procedural order setting oral argument on motions to compel
4/12/00	US WEST files motion to compel responses to data requests
4/25/00	AT&T files motion to compel responses to data requests
5/2/00	US WEST granted 1 day extension to file testimony
5/3/00	Qwest files updated testimony on revenue requirement and rate of return using the new test year
5/5/00	Procedural order setting 9/25/00 for hearing and dates for filing testimony
5/19/00, 6/9/00	Qwest files updated testimony on rate design, cost studies and RCND using the new test year
7/20/00	Procedural order continuing dates for filing direct testimony of Staff and intervenors

7/27/00	Procedural order setting revised dates for filing direct, rebuttal and surrebuttal testimony of all parties
June-Sept. 2000	Public comment sessions held in Flagstaff, Prescott, Payson, Globe, Phoenix, Tucson, Bisbee, Sierra Vista, and Yuma
8/9/00	Staff and intervenors file direct testimony
8/21/00	Qwest files rebuttal testimony
9/8/00	Staff and intervenors file surrebuttal testimony
9/19/00	Qwest files rejoinder testimony
9/19/00	Staff and Qwest file motion to continue hearing pending discussions on possible settlement
9/20/00	Procedural order continuing hearing to 10/10/00
9/21/00	Dept. of Defense files testimony
10/4/00	Qwest and Staff file second motion to continue hearing date to continue settlement discussions
10/4/00	Procedural order continuing hearing date to 10/19/00
10/17/00	Procedural order continuing hearing date to 11/29/00
10/20/00	Qwest and Staff file settlement agreement
10/27/00	Qwest, Staff and CWA file direct testimony on settlement agreement
11/8/00	Dept. of Defense files direct testimony on settlement agreement
11/13/00	Other intervenors file direct testimony on settlement agreement
11/15/00	RUCO files additional direct testimony on settlement agreement
11/20/00	Qwest and Staff file rebuttal testimony on settlement agreement
11/28/00	APA files testimony in support of settlement
11/28, 29/00	Parties file summaries of testimony
11/29/00-12/4/00	Hearing on settlement agreement
12/5/00	Qwest files motion for expedited proposed order and decision
12/8/00	Procedural order denying motion for expedited proposed order and decision
12/18/00	Parties file post-hearing briefs
12/18/00	Staff files amended settlement agreement to incorporate language clarifications discussed at hearing

SETTLEMENT AGREEMENT

Qwest Corporation (Qwest) and the Arizona Corporation Commission Staff (Staff) (collectively "the Parties") hereby agree to a settlement (the "Agreement") of the pending Qwest general rate case in Docket No.T-01051B-99-0105 (the Rate Case). The following terms and conditions, including Attachments (A) through (E) appended hereto (hereinafter referred to as the Price Cap Plan), are intended to resolve all of the issues among the Parties associated with the Rate Case.

RECITALS

WHEREAS, the Parties desire to adopt this Agreement and Price Cap Plan for Qwest to create incentives for Qwest to improve its efficiency, to provide new and innovative service offerings and to reduce the opportunity for cross-subsidization of competitive services by non-competitive services.

WHEREAS, by adopting the Price Cap Plan, the Parties intend to avoid the need for any general rate proceeding for the next three years, provide rate stability to Qwest's Arizona consumers by capping rates for essential services and create an opportunity for Qwest's customers to benefit from productivity improvements in the form of decreased rates.

WHEREAS, the Parties agree that the price caps provided for in this Agreement will ensure that rates for Qwest's telecommunications services are based on the fair value of Qwest's property devoted to the provision of intrastate telecommunications services in Arizona and to result in the establishment of just and reasonable rates for Qwest's Arizona customers; and

WHEREAS, the Parties agree that nothing in this Agreement is intended to in any way restrict or modify the Commission's current authority or jurisdiction over Qwest as provided under Arizona law; and

WHEREAS, the Parties agree that this Settlement is in the public interest.

The Recitals are only intended to convey to the reader the basic purposes, intent and limitations on the agreement between Staff and Qwest (the "Parties") that led to the settlement. While Staff believes the recitals to be largely self-explanatory, a brief explanation of each is offered. The first recital indicates the Parties' intent that the Settlement, including the Price Cap Plan, when viewed in its entirety, provides rates and a rate change mechanism, which will facilitate efficiency and innovation while minimizing cross-subsidization incentives. The second recital indicates the intent of the Parties to avoid a general rate case for the term of the Price Cap Plan (3 years), while providing rate stability to customers of basic services, including an opportunity for rate reductions as a result of potential productivity gains. The third recital indicates the understanding of the Parties that the Settlement, including the Price Cap Plan, meets the legal requirements for Commission consideration and approval, and that the rates set meet legal requirements, as well as being fair and appropriate. The final two recitals are simply intended to indicate the Parties' intent that the Settlement be construed in a manner consistent with current Arizona law, and the Parties' belief that the Settlement is in the public interest.

TERMS

1. FAIR VALUE RATE BASE AND REASONABLE RATE OF RETURN. For ratemaking purposes and in accordance with the terms of this Agreement, the Parties agree that

the "fair value" of Qwest's Arizona rate base for the test year ending December 31, 1999 (the "Test Year") is \$1,446.0 million. For ratemaking purposes and in accordance with the terms of this Agreement, the Parties agree that a reasonable return on the fair value of that rate base is 9.61%. The Parties stipulate to the adoption of the foregoing fair value rate base and reasonable rate of return and agree that the resultant increased revenue requirement, as identified in Section 2 below, results in just and reasonable rates for Qwest.

The Commission is required by the Arizona Constitution to find the "fair value" of Qwest's property devoted to the provision of public service in Arizona, determine a fair return on that fair value, and establish just and reasonable rates which provide Qwest with an opportunity to earn that fair rate of return on its fair value. The Parties agreed to adopt Staff's proposed fair value rate base and fair rate of return for purposes of the Settlement.

2. REVENUE REQUIREMENT DEFICIENCY. For ratemaking purposes and in accordance with the terms of this Agreement, the Parties agree that Qwest's jurisdictional revenue requirement deficiency is \$ 42.9 million.

The Settlement revenue requirement deficiency was the product of negotiation between the Parties. It represents the amount of annual increase in revenues that the Parties agreed that Qwest should have the opportunity to earn, in order to achieve the agreed fair rate of return on the agreed fair value rate base. The revenue requirement deficiency is stated on a test year basis. That means that rates are to be increased in an amount sufficient to recover the revenue deficiency when considered in the context of quantities sold and expenses incurred during the historical test year utilized in this case, calendar year 1999.

3. RATE DESIGN. The Parties agree that the revenue requirement set forth in Section 2 above shall be recovered through (a) a combination of increases and decreases in rates for services reflected on Attachment B hereto to recover \$ 17.6 million of Qwest's Test Year revenue requirement and (b) the opportunity for revenue from flexibly-priced services contained in Basket 3 of the Price Cap Plan discussed in Section 4 of this Agreement to recover \$25.3 million of Qwest's Test Year revenue requirement. The initial rates set forth on Attachment B include rate adjustments based on Test Year revenue levels as follows:

<u>\$ Million</u>	
23.1	Increase revenues from directory assistance rates which shall be capped at \$ 0.85 per call for one year
13.7	Increase in Private Line Services
-5.0	Reduction in Intrastate Access Charges for First Year of Agreement
-7.9	Reduction in Residential Basic Service Nonrecurring Charges from \$ 46.50 to \$ 35.00
-1.5	Revenue Reduction from Basic Residential Service from Change in U-1 Base Rate Area Boundaries
-1.9	Revenue Reduction from Basic Residential Service from Change in U-2 Base Rate Area Boundaries
-2.3	Elimination of Residential Non-recurring Zone Connection Charge
-0.2	Elimination of Business Non-Recurring Zone Connection Charge
-0.2	Revenue Reduction from Basic Business Service From Change in U-1 Base Rate Area Boundaries
-0.2	Revenue Reduction from Basic Business Service From Change in U-2 Base Rate Area Boundaries
<hr/> 17.6	Overall Immediate Revenue Change
25.3	Increase in available additional revenue in Basket 3 services except directory assistance for one year
<hr/> 42.9	Overall Net Revenue Change Authorized

The Parties further agree that rates for Intrastate Switched Access Service shall be reduced at the start of the second year of the Price Cap Plan to cause an additional \$ 5 million reduction in revenues from that service and reduced again at the start of the third year of the

Price Cap Plan to cause an additional \$ 5 million reduction in revenues. The Parties agree that the revenues available under the Cap for Basket 3 Services, as described in the next Section of this Agreement, shall be increased by \$ 5 million at the start of the second year of the Price Cap Plan and an additional \$ 5 million at the start of the third year of the Price Cap Plan to correspond on a revenue requirement basis to the reduction in access revenues.

The Parties agree that Qwest's Due Date Change Tariff and Start-Up Package Elimination Tariff may be implemented upon Commission approval of this Agreement. The Parties also agree that all multi-party grades of residential and business basic service should be eliminated. The net effect of the approval of these tariffs and the elimination of multi-party service is to increase Qwest's revenues by \$247,856 and to require investment of approximately \$4 million. These amounts are in addition to the amount set forth in section 2 as the change in revenue requirement.

The Rate Design section of this Settlement describes a series of rate changes that the Parties agree represent appropriate categories within which the agreed revenue requirement deficiency should be recovered. In some instances the rate class will receive rates that represent a decrease from existing rates, while in others those rates will represent an increase. All rate changes discussed are on a test year basis, so existing rates will be changed in such a way that the desired revenue results would have occurred had the new rates been charged during the test year. In addition, Qwest will not be implementing the entirety of the permitted rate increases at this time. A portion of the agreed revenue increase is reserved for possible recovery by Qwest raising other rates in classes where it has been granted flexible pricing. Since the services provided under flexible pricing are generally ones where competition exists,

Qwest's ultimate ability to recover the agreed revenue requirement increase is at least partially dependent upon success in the competitive market.

The Settlement provides for a staged reduction in Qwest's intrastate switched access rates. The initial rates filed after approval of the Settlement will provide a \$5 million reduction on a test year basis. In each of two subsequent years, Qwest will reduce those rates by an additional \$5 million on an annual test year basis. The revenues from the initial reduction are considered in establishing the rates to be filed after approval of the Settlement. The amount of the discretionary increases are increased in each of the two subsequent years, so as to allow Qwest the opportunity to recover the revenues lost from the reductions in switched access charges. That opportunity is the same as the opportunity provided for other portions of the revenue requirement that are not immediately implemented. Finally, the Settlement provides for the implementation of two previously submitted tariffs and the elimination of multi-party service.

4. PRICE CAP PLAN. The Parties agree to create a Price Cap Plan, described in this Section and Attachments (A) through (E) appended hereto, as part of the resolution of the Rate Case. The term of the Price Cap Plan shall be three years from the effective date as specified in the Commission's Order approving this Agreement and Price Cap Plan. The Parties agree that the initial rates set forth on Attachment B and the flexibility for Basket 3 Services under the Price Cap Plan result in just and reasonable rates for Qwest's Arizona intrastate operations. Upon approval of this Agreement by the Commission, Qwest will file its intrastate tariffs in accordance with this Agreement, which rates shall take effect as specified in the Commission's order approving of this Agreement and Price Cap Plan.

The Price Cap Plan creates three “baskets” of services. Basket 1 consists of Basic/Essential Non-Competitive Services. The services in Basket 1 are identified on Attachment C to this Agreement. Basket 1 will be capped, using an “Inflation minus Productivity” indexing mechanism, subject to annual updates in the quantity of demand as set forth on Attachment A. As a compromise to the respective positions of the parties, the productivity factor (X) for the initial term of the Plan is set at 4.2%, which includes a 0.5% consumer dividend. The productivity offset for each year of the initial term applied to the Price Index cap for Basket 1 shall be equal to $(\text{GDP-PI}) - X$, where zero is equal to or greater than “ $(\text{GDP-PI}) - X$ ”. The parties agree to conduct studies and submit productivity evidence in the scheduled review of the Plan’s initial term. Basket 2 consists of Wholesale Services. The services in Basket 2 are identified on Attachment D to this Agreement. Except as otherwise provided in this Agreement, services in Basket 2 will be capped at the levels existing on the date of execution of this Agreement and will remain subject to the specific pricing rules for those services, as interpreted by the Commission and the Courts. Basket 3 consists of Flexibly-Priced Competitive Services. The Services contained in this Basket are identified on Attachment E to this Agreement. Basket 3 will be capped at an index, subject to annual updates in the quantity of demand, which index will be calculated as set forth in subpart 4(c) of Attachment A. Notwithstanding, the additional revenue level for purposes of headroom in Basket 3, shall be capped at \$25.3 million, on a test year basis, for the term of the Price Cap Plan. Basket 3 will also be subject to an upward adjustment of \$5 million per year in the second year of the Price Cap Plan and an additional \$5 million per year in the third year of the Price Cap Plan to offset the annual reductions to intrastate switched access revenue under this Agreement. The details of

the Price Cap Plan and the procedural mechanisms for the implementation of price changes under that Plan are set forth on Attachment A to this Agreement.

Nine months prior to the expiration of the Price Cap Plan, Qwest will submit an application with its recommendation for extension, or revision of the Price Cap Plan for review by Staff, the Residential Utility Consumer Office ("RUCO") and the Commission. The Application will be available for review and comments by other interested parties. The Application will include the following information:

- a. A detailed statement of price and revenue changes effected during the initial term of the Price Cap Plan;
- b. A statement of the aggregate investment and retirements in plant, and associated depreciation for the preceding calendar year;
- c. A statement of the operating income and return on investment for the preceding calendar year;
- d. Service quality comparative data during the initial term of the Price Cap Plan as specified by Staff; and
- e. Updated analysis of productivity data applicable to the Price Cap Plan.

Staff may request and Qwest will provide, pursuant to A.R.S. § 40-204, such other additional information as Staff determines necessary for the analysis of Qwest's application. Staff agrees to withdraw its recommendation concerning a plant modernization credit, subject to a review of Qwest's capital investment during the initial term of the Price Cap Plan.

Renewal or modification of the Price Cap Plan at the end of the initial term is subject to approval by the Commission. Until the Commission approves ~~the~~ a renewal or modified Price

Cap Plan, or orders a termination of the Plan after its term, the Plan including the hard caps on Basket One Services set forth in paragraph 2(c)(i) shall continue in effect.

The Parties further agree that if the Federal Communications Commission ("FCC") or the Commission orders, adjusts or raises an assessment for the support of Universal Service during the initial term of the Price Cap Plan, the recovery of that assessment is not subject to the provisions of the Price Cap Plan and Qwest may pass through that assessment in the form of a surcharge(s) without filing a general rate case. Any additional federal or state universal service funding received by Qwest will be considered an adjustment to the price caps established under this Plan.

The Settlement Agreement only attempts a basic description of the Price Cap Plan. The referenced Attachments provide additional details as to the workings of the Plan. Nonetheless, there are several salient points to be gleaned from the text of the Settlement in describing the Plan. First, it has a term of 3 years. The Settlement contemplates that the effective date of the Plan will be specified in the Commission Order approving it. The Settlement indicates the Parties' opinion that the initial rates approved at the outset, in conjunction with rates implemented under the prescribed pricing flexibility will meet the legal requirements for the Commission's approval of just and reasonable rates for Qwest.

The Settlement describes the three "baskets" of services. Basket 1 is Basic/Essential Non-Competitive Services and are specifically listed on Attachment C. Basket 1 Services are subject to an indexing mechanism, which is capped at zero, with no lower bound. This means that if inflation exceeds productivity, the index itself will not be raised. If productivity exceeds inflation, as is more often the case, the overall index in Basket 1 will be reduced, forcing price

reductions. Essential Services in Basket 1, including Basic Residential Services, are subject to a hard cap, which means that, for the term of the Plan, they cannot increase above current levels. Other services in Basket 1 may increase up to 25% per year, or decrease, as permitted by the operation of the indexing mechanism. The productivity factor is agreed to be 4.2% annually for the initial term of the Plan, which includes a .5% consumer dividend.

Basket 2 services are Wholesale Services, and are listed on Attachment D. Other than price changes specifically provided for in the Settlement, Basket 2 services are capped at existing levels. They are subject to separate pricing rules, which are not changed by the Settlement. Intrastate access charges are decreased by \$5 million annually during the term of the Plan.

Basket 3 services are Flexibly-Priced Competitive Services, and are listed on Attachment E. The services in Basket 3 have previously been identified as competitive and granted pricing flexibility by the Commission. Basket 3 services are capped according to an index, which is described in Attachment A. As described earlier, a portion of the revenue increases allowed under the Settlement are assigned for possible recovery by Qwest increasing prices of Basket 3 services other than those services to which prices are changing under paragraph 3 of the Settlement. During the 3 year term of the Price Cap Plan, additional increases in rates of Basket 3 services are limited by a cap of \$25.3 million, on a test year basis. The Settlement does provide, as described earlier, an opportunity for Qwest to recover the test year revenues lost by reductions in Intrastate Switched Access Charges by additional increases in rates in Basket 3.

The Settlement requires Qwest to submit an application for continuation or modification of the Price Cap Plan nine months prior to its expiration, to be reviewed by Staff

and RUCO. The Settlement describes certain information that is required to accompany the application, including information on price and revenue changes that occurred during the term of the Plan, investment and retirement of plant and depreciation thereon, income and return on investment results, service quality information, as well as productivity information. The Settlement makes clear that additional information may be required and that Staff's withdrawal of its proposed credit relating to plant modernization is subject to the review of investment results during the term of the Plan.

Finally, the Settlement makes it clear that continuation or modification of the Plan is subject to Commission approval, and that the Plan will continue in effect pending a Commission decision renewing, modifying or terminating it. This section of the Settlement also clarifies that Universal Service assessments are not to be subject to the terms of the Plan and that any additional Universal Service funding received by Qwest shall be considered an adjustment to the price caps established by the Plan.

5. SERVICE QUALITY CREDITS. To ensure service quality during the initial term of the Price Cap Plan, the Parties agree that, for any year in which Qwest becomes subject to penalties under two or more of the five categories defined in Section 2.6 of the Service Quality Plan Tariff [i.e., Section 2.6.1(E) through Section 2.6.1(F)], additional credits shall be implemented after each of the initial three Price Cap Plan years if existing penalties are payable. Such additional credits shall take the form of one-time credits of \$2.00 for each residential and business access line in Arizona. Qwest shall issue these credits no later than March 31 of the year in which the foregoing Section 2.6 penalties are paid. The foregoing credits are additional to any credits and penalties provided by the Service Quality Plan Tariff. No service quality penalties or credits shall be assessed during the initial term of the Price Cap Plan other than those provided for in the

Service Quality Plan Tariff as modified by Decision No. 62672 and in this Agreement, except for any wholesale standards and penalties adopted in Docket No. T-00000B-97-0238 or in any other Commission proceeding addressing wholesale service quality standards or penalties.

For the past several years, Qwest has had a Quality of Service Plan tariff in effect. That tariff prescribes certain target levels of performance in a number of specific measures of service quality. The tariff also requires that Qwest pay credits and penalties if the required levels of service quality are not attained. The penalty and credit provisions of the Service Quality tariff were amended in conjunction with the Commission's approval of the U S WEST/Qwest merger. The Settlement further amends the terms of the Service Quality Plan tariff. If Qwest becomes subject to penalties under two or more categories from among the five identified in the existing tariff, the Settlement requires payment of additional credits in the amount of \$2.00 per residential or business access line, above those which would already be required under the tariff. The Settlement further provides that, after the changes required by the Settlement, no additional service quality penalties or credits will be imposed during the initial term of the Plan, although the Settlement also makes clear that this proceeding is not addressing wholesale service quality standards or penalties. Those remain open for consideration in separate Commission proceedings.

6. NOTICE TO CONSUMERS. Following Commission approval of the Settlement Agreement and Price Cap Plan, Qwest will provide, in two subsequent bills sent to Qwest's Arizona consumers, information regarding the services for which rates and charges may change without Commission approval. The bill inserts shall also inform Qwest's customers that essential basic services which are part of any packaged offering remain available and can be obtained by the customer as a separate offering. The bill inserts shall also inform consumers that the Arizona Corporation Commission remains the regulatory agency responsible for overseeing the terms,

conditions, rates and quality of service provided by Qwest and that complaints regarding any of Qwest's regulated services should be directed to the Commission's Consumer Services Section. The bill inserts will be provided to Staff for its review and approval prior to being sent to consumers. In connection with the implementation of this Agreement, Qwest will prepare training materials for customer service representatives to use in interfacing with customers in conjunction with the implementation of the Price Cap Plan.

The Settlement requires that Qwest provide notice to its customers of the changes in rate setting flexibility being approved under the Settlement. Specifically, Qwest is required to provide the information to its customers in the form of two bill inserts, to be reviewed and approved by Staff prior to distribution. The information to be provided to customers includes a description of the services for which rates may be changed without separate Commission approval. Qwest is also required to provide information that certain basic services remain available on a stand-alone basis at a capped price, even though those services may be provided as part of a flexibly-priced package. The Settlement requires that the bill inserts remind customers that the Commission remains the regulatory body with authority over Qwest's provision of service, and that customer complaints may continue to be submitted to the Commission. The Settlement also requires that Qwest prepare training materials, for use by its customer service representatives in assisting customers in their adjustment to the changes brought about by implementation of the Settlement.

7. MORATORIUM ON AND PROCEEDINGS FOR FUTURE RATE INCREASES. The Parties agree that no Party shall file an application for or complaint seeking an adjustment in Qwest's general rates and charges that would be effective during the initial term of the Price Cap Plan (the "Rate Proceeding Moratorium Period"). The Rate Proceeding Moratorium Period shall be extended for each additional period of extension or revision of the Price Cap Plan.

A common provision in Settlements presented to the Commission, the Parties to this Settlement agree that no general rate change proceeding will be submitted by either for a specified period of time. In this case, the agreement is for a period corresponding with the life of the Price Cap Plan.

8. COMMISSION APPROVAL AND SEVERABILITY. Each provision of this Agreement is in consideration and support of all other provisions, and expressly conditioned upon acceptance and approval by the Commission without material change. Unless the Parties to this Agreement otherwise agree, in the event that the Commission fails to accept and approve this Agreement according to its terms, then it shall be deemed withdrawn by the Parties and the Parties shall be free to pursue their respective positions in the Rate Case without prejudice.

Another common provision in Settlements presented to the Commission. The Parties, having negotiated a complete and final settlement of all issues, seek Commission approval of the Settlement in its entirety. Absent Commission approval of the Settlement, without change, the Parties reserve the right to withdraw from the Settlement and litigate the case, as filed, without prejudice to their respective positions resulting from the unapproved Settlement.

9. COMPROMISE. This Agreement represents the Parties' mutual desire to compromise and settle disputed claims and issues regarding the prospective just and reasonable rate levels of Qwest in a manner consistent with the public interest and based upon the pre-filed testimony, and exhibits and the evidentiary record developed in the Rate Case. This Agreement represents a compromise of the positions of the Parties. Acceptance of this Agreement is without prejudice to any position taken by any party in the Rate Case and none of the positions taken herein by any of the Parties may be referred to, cited or relied upon by any other party in any fashion as

precedent or otherwise in any proceeding before this Commission or any other regulatory agency or before any court of law for any purpose except in furtherance of the purposes and results of this Agreement.

This Settlement, as is usually the case, represents a compromise between the Parties. The Settlement does not reflect the adoption of either Party's positions on the issues in their entirety. Accordingly, with this provision, the Parties indicate their view that, while adoption of the outcome proposed in the Settlement is in the public interest, they do not forego their right to advocate the positions previously submitted. In addition, it is important that settled cases not establish precedent as to any particular resolution of a contested issue. This provision preserves the Parties' rights to litigate, and the Commission's right to decide issues to a contested proceeding, rather than this settled one.

10. PRIVILEGED AND CONFIDENTIAL COMMUNICATIONS. All negotiations relating to or leading to this Agreement are privileged and confidential, and no party is bound by any position asserted in negotiations, except to the extent expressly stated in this Agreement. As such, evidence of conduct or statements made in the course of negotiation of this Agreement are not admissible as evidence in any proceeding before the Commission, any other regulatory agency or any court.

Settlement negotiations are ordinarily considered to be confidential. This provision preserves the confidentiality of those negotiations.

11. COMPLETE AGREEMENT. This Agreement represents the complete agreement of the Parties. There are no understandings or commitments other than those specifically set forth

herein. The Parties acknowledge that this Agreement resolves all issues that were raised in the Rate Case and is a complete and total settlement between the Parties.

This provision is self-explanatory and is another common provision in settlements presented to the Commission. There are no unwritten corollary agreements between the Parties, and the Parties believe this Settlement resolves all contested issues in this proceeding.

12. SUPPORT AND DEFEND. Each Signatory Party will support and defend this Agreement and any order entered by the Commission approving this Agreement before the Commission or other regulatory agency or before any court in which it may be at issue.

Another common settlement provision, the Parties simply commit to the defense of this Settlement in other forums, should it be attacked.

13. APPEALS AND CHANGE OF LAW. The Parties hereto believe that the Settlement Agreement and Price Cap Plan provided for herein are lawful and consistent with the Arizona Constitution and case law interpreting the Arizona Constitution. If the Arizona courts should ultimately find, in a final, nonappealable order, that the Price Cap Plan is unlawful, or there is other significant change in controlling federal and state law, Staff and Qwest shall review the court decision or other change in law and discuss whether the Plan can be modified to meet the order or change in law. Further, Qwest shall have no obligation to refund revenues collected during the period of time the Price Cap Plan is in effect. If Staff and Qwest are unable to reach an agreement on how to modify the Price Cap Plan, the Plan shall end, and the Commission shall determine the appropriate method of regulation for Qwest.

This provision provides a mechanism for consideration of the impact of any court

order affecting the lawfulness of the Settlement. The Parties agree to make joint attempts to resolve any issues presented by such a court order, before resorting to litigation. If those discussions fail, the Settlement leaves the issue to a Commission determination, although any agreed plan would likely require Commission approval, in any event. In addition, the Parties agree that no refund obligation will accrue to Qwest if the Price Cap Plan were found to be unlawful. While the overall outcome of the Settlement is a rate increase, not all individual rates are raised under the Settlement Agreement. Some rates are lowered by the adoption of the Agreement and other rates may change pursuant to the pricing flexibility permitted under the Price Cap Plan. If, following an appeal, an attempt were made to undo the effects of the Settlement for the period it was in place, refunds and surcharges would have to be implemented. This provision, in essence, provides that because of the complexity and difficulty of calculating and implementing refunds and surcharges, no refunds or surcharges shall be required.

DATED this 20th day of October, 2000.

ARIZONA CORPORATION COMMISSION
UTILITIES DIVISION STAFF

BY: _____
Deborah Scott, Director

QWEST CORPORATION

BY _____
Teresa Wahlert, Arizona Vice-President

Attachment A:
Terms, Conditions and Operation of the Price Cap Plan

Price Cap Plan

- 1) Baskets
 - a) Basket 1: Basic/Essential Non-competitive Services
 - b) Basket 2: Wholesale Services
 - c) Basket 3: Flexibly-Priced Competitive Services

The Basket names are intended to be descriptive of the nature of the services in each. As explained in the summary of the Settlement Agreement, Basket 1 services are basic, essential, and usually non-competitive services, and requiring fuller regulation. Basket 2 services are wholesale, each subject to its own pricing regulations, and not the subject of detailed pricing rules under this Settlement. Basket 3 services are already deemed competitive and granted pricing flexibility. The Settlement expands, in part, the pricing flexibility, while retaining control over the extent of potential price increases for any individual service, as well as total revenues to be recovered from the Basket as a whole,

- 2) Basket 1: Basic/Essential Non-competitive Services
 - a) A list of the individual services in Basket 1 is appended hereto as Attachment C.
 - b) Cap on Basket 1
 - i) The Arizona Corporation Commission ("Commission") Staff recognizes the advantages of an "Inflation minus Productivity" price cap index mechanism. Given the uncertainty of recent interpretations of Arizona law regarding rate increase mechanisms, for the initial three year term of the plan, the weighted average price level (or "Price Index") of all services contained in Basket 1 is capped, using an "inflation minus productivity" indexing mechanism, subject to annual updates in the quantities of demand for each service.
 - ii) The Productivity Offset, which is the X Factor in the formula in subpart 2 b) vi) below, shall be equal to 4.2 percent.
 - iii) The measure of inflation used in the Price Cap Index mechanism is the annual percent change in the Gross Domestic Product Price Index ("GDP-PI"), using a seasonally-adjusted, chained price index, as calculated by the Department of Commerce. The percent change in the GDP-PI from the most recently available quarter and the same quarter from the previous year, shall be the basis for the calculation of inflation in the Price Cap Mechanism. The "Inflation minus Productivity" calculation shall be performed once annually on January 1st.
 - iv) The "Inflation Minus Productivity" calculation shall be capped at zero and has no lower bound. Therefore, the Price Cap Index is capped at 1.00 and has no lower bound.
 - v) In the first quarter of the third year of the Price Cap Plan, Qwest shall file, along with other required materials, productivity evidence for the past 2 years under price regulation.
 - vi) The formula for the Price Cap Index for Basket 1 is:

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$$1.00 + \% \Delta \text{GDP-PI} - \text{X Factor} \geq [\text{SUM } [P_N * Q_{e_b}]] / [\text{SUM } [P_{e_b} * Q_{e_b}]]$$

The numerator of the Price Cap Index of Basket 1 is the sum of the proposed/new prices multiplied by the "current base year" quantities of demand. ~~Current demand will be the quantities of demand from the most recent year.~~ Where price changes have not occurred, the ~~current/existing~~ base year price of the service is used. The denominator is the sum of ~~existing~~ base year prices multiplied by the "current base year" quantities of demand. Section (65) below details the data that Qwest shall provide to enable calculation and monitoring of the cap.

With each price change, Qwest must provide the existing and new price to Staff, as well as Qwest's calculation of the Price Index following implementation of the price change. Staff will use the Price Cap Database to check Qwest's calculation. All price changes must be demonstrated to be within the cap. The Price Cap Index calculation will be cumulative in a given year.

c) Service Pricing Flexibility

- i) Certain Basic services are to be capped at their initial levels throughout the term of the Price Cap Plan. These service prices may be reduced as they are included in the calculation of the Basket 1 Price Index. These services are: flat rate residential; flat rate business; 2 & 4 party service; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX Trunks, including features; Caller ID block; toll blocking; 900/976 blocking; and basic listing service.
- ii) The remaining services in Basket 1 may increase or decrease within the band established by the Price Index.
- iii) Individual service ~~prices~~ rate elements within Basket 1, other than those services listed in subpart i) above [services subject to the hard cap], may increase no more than 25 percent within a year.
- iv) Individual service prices must exceed the service's Total Service Long Run Incremental Cost ("TSLRIC"), unless a different cost standard applicable to all telecommunications service providers is determined appropriate by the Commission. Individual service prices must also comply with the imputation requirements of A.C.C. R14-2-1310(c), as applicable.
- v) Changes to Terms and Conditions of services in Basket 1 shall be submitted to the Commission for Staff review and approval. All services in this Basket shall be continued statewide at the tariffed rate, unless or until the Commission orders retail geographic rate de-averaging, or unless Qwest demonstrates a cost difference for a new service on which to base the price difference. Nothing in this Price Cap Plan shall preclude the Commission from deaveraging wholesale rates on a cost basis.

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- vi) Price increases for services in this Basket require 30 day notice to the Commission by submission to Staff, and 30 days notice to consumers.

This section of the Price Cap Plan provides extensive, detailed descriptions of the manner in which the Plan controls pricing of Basic services. The list of specific services to be subjected to treatment as Basket 1 services is contained in Attachment C. Subsection b explains the workings of the cap on Basket 1 services. The Plan is designed to ensure that the overall price of basic services do not increase, but may decrease to the extent productivity growth exceeds inflation during the term of the Plan. Any increases in prices to certain services would be done to offset decreases in prices of other services, all subject to the Indexing mechanism.

As explained in conjunction with the Settlement Agreement, certain Basic Services, including Basic Residential Exchange Services, are subject to a "hard" cap, as described in section 2)c)i), and may not be increased during the term of the Plan beyond existing levels, although they may be decreased to meet the requirements of the Price Cap Index. The other Basket 1 services may be increased up to 25% per year, or decreased, depending on the requirements of the Price Cap Index mechanism. Pricing flexibility for Basket 1 services is specified in some detail by the subparts of section 2)c).

The Price Cap Index mechanism is designed to ensure that prices do not rise on an aggregate basis. The Price Cap Index is capped at 1.00, which, in conjunction with the capping of the Inflation Minus Productivity calculation at zero, ensures that overall prices may not increase during the term of the Plan. If productivity increases exceed inflation, as has commonly been the case over the past several years, the mechanism ensures that overall prices for Basket 1 services will decline.

In addition, the Plan defines the Inflation Measure to be used in the calculation, describes the manner in which sales growth will be treated so as to prevent distortions. The Plan also specifies information filing requirements on the part of Qwest, designed to ensure that the Plan is properly administered and by which the Staff and Commission may consider changes to the Plan in the context of the proceeding at the close of its initial term.

3) Basket 2: Wholesale Services

- a) The services included in Basket 2 at the Price Cap Plan's inception include: Intrastate Carrier Switched Access, Discounted Wholesale Offerings, Unbundled Network Element (UNE) Offerings, Wholesale services such as PAL lines, and all other wholesale offerings unless specifically listed in Attachments C and E as included in either Basket 1 or 3. A list of wholesale services, with the exception of UNEs, included in Basket 2 at the Price Cap Plan's inception is contained in Attachment D.
- b) Basket 2 consists of wholesale services many of which are governed by their own specific pricing rules and will continue to be governed by such rules, as interpreted by the Commission and the Courts, under this Price Cap Plan.

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- c) UNEs and discounted Wholesale Offerings are priced based on the provisions of the Telecommunications Act of 1996 (1996 Act), FCC implementing regulations and Commission rules.
- d) An exception includes Intrastate Switched Access Services which are to be reduced by \$5 million per year for the duration of the initial term of the Plan, with further reductions in Intrastate Switched Access Service rates taking place during any subsequent term of the Price Cap Plan with the objective of obtaining parity with interstate switched access rates.
- e) Service prices are capped for the term of the Price Cap Plan, or until the specific pricing rules are changed or the Commission determines that other prices are appropriate.
- f) New wholesale services are to be added to this Basket when those services are implemented.
- g) ~~Nothing in this Price Cap Plan is intended to change or modify in any way the imputation requirements contained in A.A.C. R14-1-1310.~~

This section of the Plan describes the treatment accorded to Wholesale Services, as listed in Attachment D and described in section 3)a). As explained in conjunction with the Settlement Agreement, many wholesale services are subject to their own specific pricing rules, which are not changed by the Settlement. Specifically, pricing for unbundled network elements ("UNE"s) and discounted wholesale offerings are governed by the provisions of the Telecommunications Act of 1996, which provisions are not changed by this Settlement Agreement. This section describes the agreed changes to pricing of Intrastate Switched Access Service. It also provides that service prices are capped for the term of the Plan, unless changes occur pursuant to the existing or changed specific pricing rules applicable to a service. By agreement between the Parties, the provision requiring continued compliance with the Commission's imputation requirements was deleted from this section of the Plan, and reinserted in the following section in order to clarify its applicability in connection with flexibly-priced services.

- 4) Basket 3: Flexibly-Priced Competitive Services
 - a) This Basket includes only those services that have been accorded pricing flexibility or have been determined by the Commission to be competitive under A.A.C. R14-2-1108 , and new services and new service packages offered by Qwest. Any new services and new service packages offered by Qwest shall be subject to the prior review and approval of the Commission, as provided in subpart e) below. A list of services included in Basket 3 at the inception of this Price Cap Plan is appended hereto as Attachment E.
 - b) The price cap for this Basket is the weighted average price level of all the services in the Basket as calculated by the formula set forth in subpart c) following, subject to annual updates in quantities. Notwithstanding, the additional revenue level for purposes of headroom in Basket 3, shall be capped at \$25.3 million, on a test year basis, for the term of the Price Cap Plan. The price cap will be adjusted

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upward \$5 million in the second year of the Plan and an additional \$5 million in the third year of the Plan, to reflect the switched access charge reductions in those years.

- c) The formula for the calculating the Price Cap Index for Basket 3 is:

$$1.0 \geq [\text{SUM} (P_n * Q_{eb})] / [\text{SUM} (1.10 * P_{eb} * Q_{eb})]$$

The numerator is the sum of the proposed/or new prices multiplied by the "current base year" demand. ~~Current demand will be demand from the most recent year.~~ Where price changes have not occurred, the current/existing base year price of the service is used. The denominator is the sum of 110 percent of the existing base year prices multiplied by current base year demand. P_b and Q_b are the prices and quantities of the services in the basket in the "base" year of the plan. For new services and packages the P_b and Q_b are the price and quantities for the first full year in which the service is offered. See 4(d) below for further explanation of the appropriate data to be used for new services and packages. The 10% increase allowed under the Price Cap Index for Basket 3 is for the term of the Price Cap Plan.

- d) New services and service packages shall be added to the calculation of the price cap index, in both the numerator and denominator, at the end of the year in which they were introduced, to obtain actual experience with the service, so the calculation is not based solely upon projections. Qwest shall provide notification to Staff of the new services/packages and their prices as provided in subpart e) below. Once a full year's worth of actual demand is available for use in the Price Cap Index, that demand should be the "base" year demand to be used.
- e) Any services in Basket 1 may be the components of any new package that would be offered in Basket 3. Each Basket 1 service that is included in a package offered in Basket 3 shall continue to be offered in its current form in Basket 1 as of the commencement of the Price Cap Plan. Such new packages that involve the capped services in Basket 1, or any new services proposed to be included in Basket 3, shall be submitted at least thirty days in advance of the proposed effective date of the tariff of the new package or service and shall be subject to Commission consideration as provided in A.R.S. § 40-250. The Commission retains the right to reject any proposed classification or filing. The price of the new package or service shall exceed the TSLRIC of the package or service and comply with the imputation requirements of A.C.C. R14-2-1310(c). For purposes of combining Basket 1 services with Basket 3 services and setting a floor for that package, the imputed price of 1FR service shall be the applicable existing retail price for ~~that service~~ 1FR.
- i) Qwest shall be required to inform consumers, through its marketing of such new packages, including through its bill inserts, educational materials and customer representative scripts, that the services in Basket 1 remain available and can continue to be purchased as separate offerings.

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- ii) The mere repackaging of existing Basket 1 services does not ~~qualify the existing services to be "new services."~~ create a "new service" or "new service package" for purposes of the Price Cap Plan.
- f) Individual service and package prices must provide revenues in excess of the service's or package's TSLRIC subject to the provisions of subpart e) above, unless a different cost standard applicable to all telecommunications service providers is determined appropriate by the Commission. The individual service and package prices must also comply with the imputation requirements of A.A.C. R14-2-1310(c).
- g) New services and packages in Basket 3 may be offered to selected customer groups based on their purchasing patterns or geographic location, for example. This provision shall not be construed to permit red-lining based on criteria such as wealth or race, or to permit Qwest to discriminate against any class of customers in violation of A.R.S. Section 40-334.
- h) Existing services in Basket 3 shall continue to be offered to existing customer groups. Qwest must receive Commission approval for discontinuation or revision of services, terms and conditions.
- i) A Basket 1 service may be moved to Basket 3 upon Qwest meeting the criteria of R.14-2-1108. Staff and Qwest agree that Staff will process such an Application as expeditiously as reasonably possible and, in any event, will complete such processing within a period of six months, unless another time period is agreed to by Qwest, or the six month time period is waived by the Commission.
- j) If a service is moved from Basket 1 to Basket 3 because it has met the criteria of R14-2-1108, the Basket 3 price and quantities for the numerator and the denominator for that service shall be the prices and quantities for that service contained in the numerator of the Basket 1 PCI formula at the time that the service is moved, and the 1.1 factor will not be applied to these services for the remaining term of the plan.
- k) The Commission's existing rules (A.A.C. R14-2-1109) which prohibit cross-subsidization of competitive services (Basket 3) by non-competitive services (Baskets 1 and 2) shall continue to apply to all services offered by the Company under this Price Cap Plan.
- l) Price changes to flexibly priced and competitive services contained in Basket 3 shall comply with the requirements of A.A.C. R14-2-1109.

This section of the Plan describes its applicability to flexibly-priced services. Subsection a) explains that Basket 3 includes only services already accorded pricing flexibility or determined by the Commission to be competitive, and new services and service packages. It also explains that Commission review and approval is required for inclusion of new services and service packages into Basket 3. The list of services included in Basket 3 at the inception of the Plan is in Attachment E.

Subsection b) describes the price cap for Basket 3 services. The actual calculation of the price cap involves interaction among subsections b), c), and d). The Price Index referred to in subsection c), along with the treatment of new services and new service

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packages described in subsection d), act to provide a limitation to a 10% increase in gross revenues within the basket over the term of the Plan. Subsection b) modifies that limitation by adding a total dollar limit on a test year basis. Thus, the limits on gross revenue increases to Basket 3 services can be stated as: a 10% increase, not to exceed \$25.3 million on a test year basis, subject to an increase of \$5 million on a test year basis in each of the two subsequent years of the Plan.

Subsection e) describes certain limitations on the introduction of new services and new service packages as Basket 3 services. It requires that any Basket 1 service included in such a new service package must continue to be offered in Basket 1. It also subjects new service offerings to Commission review in the same manner as tariff filings have always been considered. Subsection e) also includes pricing limitations and informational requirements connected with the addition of new services and new service packages within Basket 3.

The remaining subsections describe specific limitations on pricing of Basket 3 services and requirements associated with moving services from Basket 1 to Basket 3. The basic price floor of Total Service Long Run Incremental Cost ("TSLRIC") is maintained, unless the subject of a general change by the Commission. Basket 3 services are afforded flexibility with regard to offerings to selected customer groups; however, specific limitations that prohibit discriminatory treatment of customers are prescribed. Provisions for moving services from Basket 1 to Basket 3 are provided, including treatment of those services in calculation of the Price Cap Indices. Finally, explicit prohibitions against cross-subsidization and limitations on pricing are included.

5) Annual Filing of Price Cap Data

- a) Price Cap Database: For the first year of the Price Cap Plan, Qwest will file, in electronic form, an Excel spreadsheet that is a database of the prices and quantities of each service in Baskets 1 and 3. The spreadsheet will include the formula for calculating the index of Baskets 1 and 3. The spreadsheet format should enable the Staff to type in a price change and instantaneously observe the effect of the price change on the weighted average price level of the affected Basket. The data in the spreadsheet shall include the following columns for each Basket:

Basket X: (Denominator or Numerator of Price Index)					
Service Name	Tariff Section	Date of Most Recent Price Change	Price	Quantity Demanded	Revenue
A	x.x	01/01/2001	\$x.xx	x,xxx	\$xx,xxx
B	x.x	01/01/2001	\$x.xx	x,xxx	\$x,xxx
TOTAL	----	----	----	----	\$xxx,xxx

This data will be fixed for calculation of the Price Index denominator at each service's price at the beginning of the Price Cap year. A second set of this same data shall be included in the spreadsheet for each Basket and will be updated with

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each price change throughout the year, cumulatively, in order to calculate the Price Index numerator. The Index for the Basket is calculated as the ratio of the numerator data over the denominator data, as described above for each Basket. The calculated Price Index for each Basket shall remain below the Basket's assigned Price Cap in order for rate changes to be considered lawful upon filing. The spreadsheet shall be equipped with the formula that enables instantaneous verification that a price change by Qwest is within the prescribed cap. For the initial prices, it will suffice to establish the date of most recent price change at 01/01/2001 for all services, particularly if the last price change is unknown. For each subsequent year of the Price Cap Plan, the most recent price change may be recorded as 01/01/xx, to indicate the starting price for the service in year xx.

- b) The Price Cap Database shall be updated annually, reflecting end of year prices and quantities which represent existing prices and current quantities to be used in the next year of the plan.
- c) As individual price changes are filed, the Staff shall examine their effect on the affected Baskets' Price Index, using the Price Cap Database. If a price change results in a Price Index above the Cap, the price change does not comply with the Plan and Staff may recommend rate reductions that should occur in order to meet the constraints of the Cap.

This section of the Price Cap Plan describes the informational requirements by which Staff and the Commission will be able to monitor the implementation of the Price Cap Plan. The informational requirements will allow Staff to calculate the impact of price changes continuously to ensure compliance with the requirements of the Plan, as well as annual updates that will permit review of the impacts of the Plan over time.

- 6) Renewal of the Price Cap Plan
 - a) The Price Cap Plan shall have an initial term of three years at the end of which Qwest may propose to either:
 - i) Renew the Price Cap Plan under the current terms and conditions; or
 - ii) Renew the Price Cap Plan with proposed revisions.
 - b) Qwest's proposal shall be filed along with other monitoring information requested at the end of the first quarter of the third year of the Price Cap Plan.
 - c) Whether and under what terms and conditions to renew the Price Cap Plan will be determined by negotiations among Staff, Qwest, and other parties subject to the Commission's approval. Contested hearings on renewal of the plan may or may not occur depending on the disposition of negotiations among parties. Nothing herein, however, shall preclude any party from requesting a hearing on the Company's proposal to renew the Price Cap Plan. Nothing herein shall affect the Commission's jurisdiction or authority to determine the most appropriate form of regulation for Qwest at the end of the three year term of the Price Cap Plan, including termination of the Plan.

Attachment A:
Terms, Conditions and Operation of the Price Cap Plan

This section of the Price Cap Plan is simply designed to provide a description of the process under which the Commission will act in considering renewal of the Plan at the conclusion of its initial term. The process requires filing of a proposal for renewal of the Plan nine months prior to its expiration, so that all interested parties may have input and the Commission may fully consider options before the actual expiration of the initial term of the Plan.

7) Applicability of Commission Rules

- a) Unless expressly provided herein, this Price Cap Plan is not intended to alter or eliminate the application of current Commission rules and orders to Qwest.
- b) Nothing in this Price Cap Plan is intended to change or modify in any way the imputation requirements contained in A.A.C. R14-2-1310.

This section of the Price Cap Plan is intended to ensure that the Plan is not construed to have amended any Commission Rules, other than where explicitly provided by the Plan. This section has been amended to specifically indicate that the Plan does not modify the Commission's imputation rules.